Philippine Economic Outlook

JANUARY 2000

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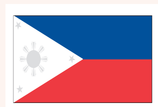
Introduction

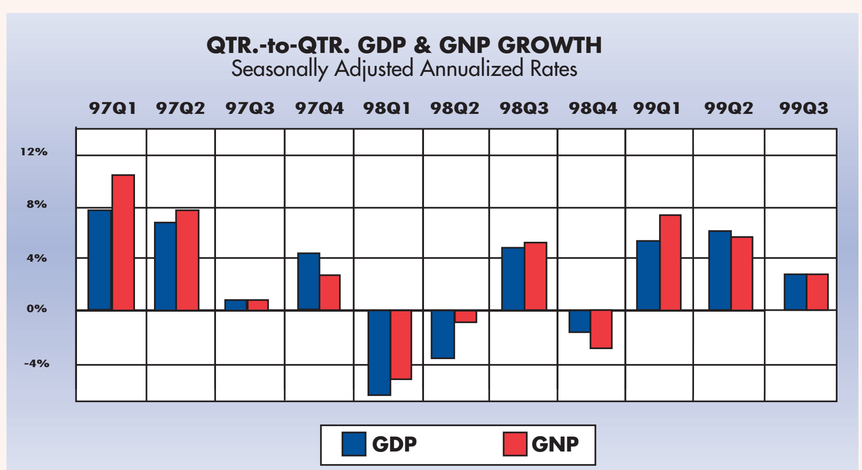


With three consecutive quarters of growth behind it, the Philippine economy has recovered from the limited effects of the Asian economic crisis. It now faces the more serious and long-term challenge of implementing the broad structural changes needed to sustain and enhance economic growth. The near-term outlook is positive, but sustained future growth will depend on how well the government and the economy deal with persistent structural weaknesses, fiscal imbalances, and the accelerating trend of globalization.

The stable foundation of the Philippine economy has been the banking sector, which suffered little during the 1998 regional crisis. Past experience had created a banking sector and regulatory framework that was well-equipped to withstand the strain of capital flight. The banking sector is now being pushed by new forces to consolidate. Chanting the mantra of "bigger is better," merger and acquisition fever has bankers rushing to put together deals to create banks that can compete on a regional and international scale. These moves are creating new challenges for regulators, as are blurring lines between banks and other financial institutions. Regulators will need continued flexibility and quick-footedness like that demonstrated during the crisis.

Most of the ongoing recovery has come in the agricultural sector, which was hit hard by poor weather in 1997-1998, and so is coming off a low base. Third quarter GNP growth of 3.1% (year-on-year) was below the second quarter rate (of 3.6%) as agriculture's recovery decelerated. Industrial output broke a stretch of five consecutive quarters of year-on-year decline to grow an unremarkable 0.2%. Export growth has continued, and even gained strength. Interest rates on 91-day T-bills fell, due to concerted government efforts and increased liquidity in the banking sector, from nearly 13.5% at the start of 1999 to about 8.4% in August. They have since stabilized just under 9%. Credit growth, however, remains weak. The peso is trading between P40-41 per US$1.00, fluctuating more on regional trends and domestic rumors than on fundamentals. The Philippine Stock Exchange saw a steady rise in prices in the first seven months. The main index peaked above 2,600 in July, but the early gains were surrendered in the second half of the year. The main index remained below 2,100 through most of the fourth quarter. Inflation continues to moderate, both due to improved agricultural output and weak consumer demand. Perhaps the most serious challenge facing the government in the near- to medium-term is poor fiscal performance, particularly weak revenue collection.

The Philippines was well positioned after the Asian crisis to create faster and sustainable economic growth. To do that, policymakers must seriously address the following issues:



* Continuing trade and tariff reforms leading to more open markets
* Removing barriers to foreign investment
* Improving agricultural productivity and infrastructure in rural areas
* Restoring fiscal balance by improving tax administration and rationalizing a bloated bureaucracy
* Continuing liberalization in financial markets, electric power, and telecommunications
* Reducing the government's role in the economy through privatization, and
* Improving transparency and accountability in government.

Output and Inflation

Third quarter real GDP grew 3.1% year-on-year and real GNP by 3.3%. On a cumulative basis, nine-month GDP and GNP grew 2.6% and 3%, respectively, over 1998 levels — on track towards achieving the government's 3% GDP and 3.5% GNP growth target for the full-year. Seasonally adjusted quarterly estimates (which do not show much detail) show real GDP and GNP increasing quarter-on-quarter for a third consecutive quarter, confirming that the brief 1998 recession has ended.

The third quarter's 3.1% year-on-year GDP expansion was down from the second quarter's 3.6% growth rate. Not surprisingly, agricultural sector growth decelerated to more normal levels after rising 11.1% in the second quarter over an exceptionally low 1998 base. Government expenditures also slowed markedly after being "front loaded" during the first half of the year. Persistent tax collection shortfalls led the government to scale back spending plans in the second half of the year. The industrial sector finally mustered some growth of 0.2% which, while unremarkable, represented a turnaround from five consecutive quarters of year-on-year declines. Manufacturing output expanded for a second consecutive quarter, and at a faster pace (2.2%).

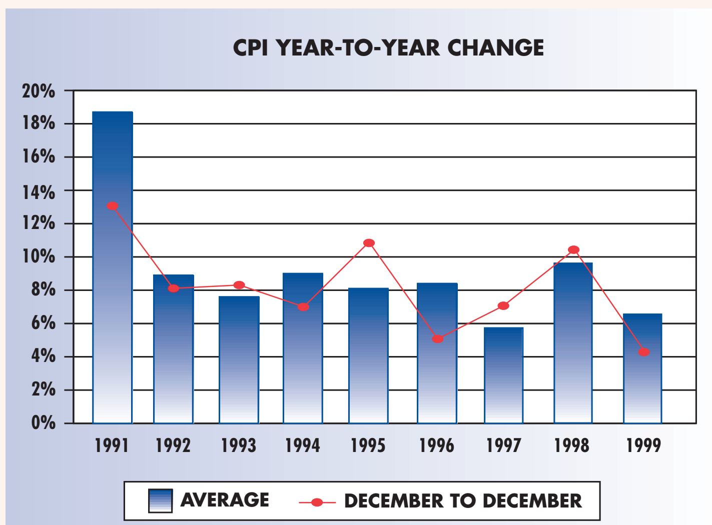
On the demand side, the third quarter's slower expansion reflected a decline in both fixed capital investments and inventory accumulation. Fixed capital spending contracted from the third quarter of 1998 as slower public sector construction combined with still depressed private construction demand. Investments in durable equipment also softened as industries continued to experience low capacity utilization. The second quarter's net inventory drawdown continued into the third quarter, demonstrating a lack of confidence in rising overall demand. It is impossible to tell yet whether the inventory reduction process has run its course so that future demand can translate into increased output. At 2.6%, personal consumption has expanded only a little faster than population growth (2.3%) since the beginning of the year, translating to minimal growth in real per capita terms. Manufacturers of mass market consumer goods like soft drinks and household products all report weak sales.

We have maintained our 2.7% to 3.1% full-year 1999 GDP forecast. Our current projection is for real GDP to expand between 3.5% and 4.2% in the year 2000. Achieving even that growth will hinge heavily on the pace of recovery of the private, non-agricultural sector. Beyond the short-term, sustained growth will depend on improved business confidence. This, in turn, will require clear and consistent government support for continued liberalization and market-based reforms, as well as more aggressive efforts to address the weak state of government finances.

Stable food prices after 1998's drought-induced losses and late-year typhoons tempered the effect of rising fuel prices and increased utility rates arising from increased world crude costs. In September, the government adjusted its full-year average inflation forecast downward to between 7% and 8% (from between 8% and 9% previously). The twelve-month inflation rate, which opened 1999 at 11.5% in January, had declined below 6% by mid-year and ended 1999 at 4.3% in December. The more pronounced deceleration in the last two months of 1999 reflected an abnormally high 1998 base from late-year typhoons. Year-on-year inflation averaged 6.6% in 1999, below even the lower end of the government's downward-revised projection. Our current forecast is for full-year 2000 inflation to average 7.0% to 7.5% as fuel price hikes, minimum wage increases and recovering domestic demand weave their way into overall price levels. That projection also reflects the fact that, unlike 1999, year 2000 prices will no longer be coming off an unusually high base.

Labor and Employment

The unemployment rate (computed as the average of quarterly surveys) declined from 10.1% in 1998 to 9.6% in 1999. From 0.7% growth in 1998 (equivalent to less than 200,000 jobs), the number of employed expanded by 3.8% (equivalent to more than one million jobs). The agricultural sector, rebounding from 1998's drought, accounted for 65% of the new jobs generated during 1999, with the relatively resilient service sector also contributing. However, overall industrial sector employment sputtered for a second consecutive year, contracting by 1% on top of a similar decline in 1998. While agri-



* Base Year 1994 beginning 1997 (revised series based on results of Government's 1994 Family Income and Expenditure Survey). Base Year 1988 for data prior to 1997.

culture may have generated most of 1999's new jobs, the sector accounts for 40% of total employment but only 20% of GDP. The sector's low productivity hampers growth because agriculture is an inefficient supplier to industries. At the same time, the agricultural population, with its very low income, does not provide a strong consumer base to increase demand.

Oil price increases at the end of September led to a substantial increase in local transportation fares in October. This was followed immediately by trade union demands for commensurate wage increases. President Estrada announced his support for wage hikes and ordered all 16 regional wage boards to fast-track their procedures. In Metro Manila, the minimum daily wage for non-agricultural workers rose about 13% to P223.50 (about $5.60) as of October 31. This was less than half the amount the Trade Union Congress of the Philippines had sought. The unions stressed that the approved wage increases would merely help workers keep abreast with inflation and would not provide an adequate living wage. In the six regions for which increases were approved and implemented as of December 1, there was an average increase for non-agricultural workers of P17 (about 43 cents) per day. Increases for agricultural workers were generally more modest. Similar wage hikes in nine of the remaining ten regions are expected to take effect early in 2000.

Government employment policies have focused on boosting investment — both foreign and domestic — to generate jobs. Job losses and plant closures in the past few years, particularly recent moves by some multinational firms to restructure or close plants in the Philippines, has led Philippine policy makers to consider revisions to the labor code to make it more flexible.

Financial Markets

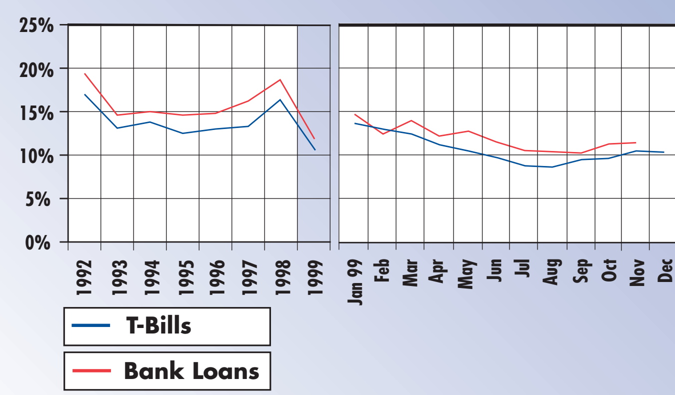
Domestic interest rates bottomed out in early August. The 18-month downward trend had been fueled by rising liquidity in the banking sector and aggressive government efforts to bring down key rates. Rafael Buenaventura — a veteran commercial banker who assumed office last July as Governor of the Bangko Sentral ng Pilipinas — adopted a more conservative interest rate policy. His only major policy moves since assuming office have been: a) adopting a two-tiered rate since August for funds placed by banks with the BSP (with a lower-than-published rate applying to funds beyond a certain amount); and b) cutting overnight rates by 25 basis points in November. Both moves were directed at encouraging banks to shift more of their funds to lending. Effective December 15, 1999, the Bangko Sentral raised its overnight lending rate by a full percentage point (from 11% to 12%) to prevent arbitrage of its special Y2K facility. Governor Buenaventura's more cautious policy stance stemmed from concerns that resurgent foreign exchange pressures and narrowing differentials between domestic and foreign yields (partly reflecting upward adjustments in key U.S. rates) could threaten the peso's stability. Meanwhile, the government's increasingly strained fiscal situation frustrated the Philippine Treasury's efforts to keep rates at government bond auctions moving down. Benchmark 91-day T-bill rates — which opened 1999 at 13.5% — bottomed out at 8.38% in early August and then began inching up close to the 9% mark. The government has also worked in the fourth quarter of 1999 to take advantage of the financial system's current liquidity by adjusting its borrowing mix towards longer-term T-bill and T-bond instruments.

Private sector borrowing has been slow to pick up despite government efforts to encourage lending. Commercial banks' overall loan portfolio inched up month-on-month from May to September 1999 after declining in the first part of the year. Total loans as of September finally reached the end-1998 level, pointing to the possibility of at least modest growth year-on-year by end-1999 (following a 2% contraction in 1998). Banks continue to grapple with much higher levels of bad debts than before the crisis. The measured ratio of commercial banks' non-performing loans (NPLs) stood at about 13.4% of total loans as of September 1999, compared with 10.4% in December 1998 and less than 4% before the Asian crisis. As of September 1999, commercial banks' aggregate "non-performing assets" — the sum of NPL's and foreclosed assets — were 37% higher than at end-1998 and more than 4.5 times the pre-crisis level. Restructured loans — without which NPL ratios would be higher — accounted for 4.2% of total bank loans as of end-September 1999, more than quadruple the mid-1997 ratio. Most banks have acted to boost their loan loss reserves. Loan loss provisions stood at 4.9% of total credits, from 1.3% before the Asian crisis.

Partly because of an ongoing, staggered build-up in minimum capitalization requirements (announced in March 1998 and continuing through end-2000), the banking system has remained generally resilient despite rising levels of bad loans. Latest estimates place the banking system's capital adequacy ratio at over 17.5%, up from 16% as of end-1998 and well above the BSP's required 10% level. Analysts estimate that even an NPL ratio of 15% or a bit higher would not threaten the soundness of the banking system. Only one small commercial bank closed during the crisis and evidence indicates that it was the victim of excessive lending to related companies. The approximately 900 smaller thrift and rural banks have been more severely shaken, but these account for less that 10% of total banking system assets. The authorities have closed 76 rural and thrift banks since mid-1997. The closed banks thus far constitute less than one-half of one percent of the total resources of the Philippine banking system.

The Bangko Sentral continues to actively promote greater consolidation among banks and other financial intermediaries to develop stronger financial institutions better able to cope with the opportunities and challenges of globalization. Last August, the Bangko Sentral declared a temporary moratorium on new banking licenses in order to encourage mergers and acquisitions among existing players. The Bangko Sentral is also mulling possible measures to discourage banks from merely "downgrading" their status in order to skirt higher capitalization rules. At least six agreements for mergers or acquisitions in the commercial banking sector have been formally announced since the beginning of the year. These include two mergers involving four of the country's largest commercial banks — Equitable Banking Corporation with Philippine Commercial and Industrial Bank (announced last May), and Bank of the Philippine Islands with Far East Bank and Trust Company (announced last October). These are not likely to be the last, with several other banks reportedly exploring potential partnerships.

AVERAGE DOMESTIC INTEREST RATES



*As recorded by Bangko Sentral, lending rate refers to ratio of actual interest income to outstanding loans, rather than to banks' quoted rates for new loans. T-Bill rate is weighted average for all maturities.

The Philippine stock market remains vulnerable to quick reversals. After starting the year at just below the 2000 mark, the Philippine Stock Price Index (Phisix) rose fairly steadily from March to July to peak just above 2,600. But it has given up most of those gains since then, succumbing to the combined effects of higher domestic interest rates, weak corporate earnings, and resurgent foreign exchange uncertainties. Political jitters resulting from a convergence of news and negative sentiment (among them President Estrada's declining popularity rating, rising concerns over corruption and cronyism, and rumors of a cabinet revamp) also contributed to softer stock prices in the second half. The Phisix — which closed at a 1999 high of 2,621.27 in early July — ended the year at 2,143, 8.8% higher than at the end of 1998.

Fiscal Performance

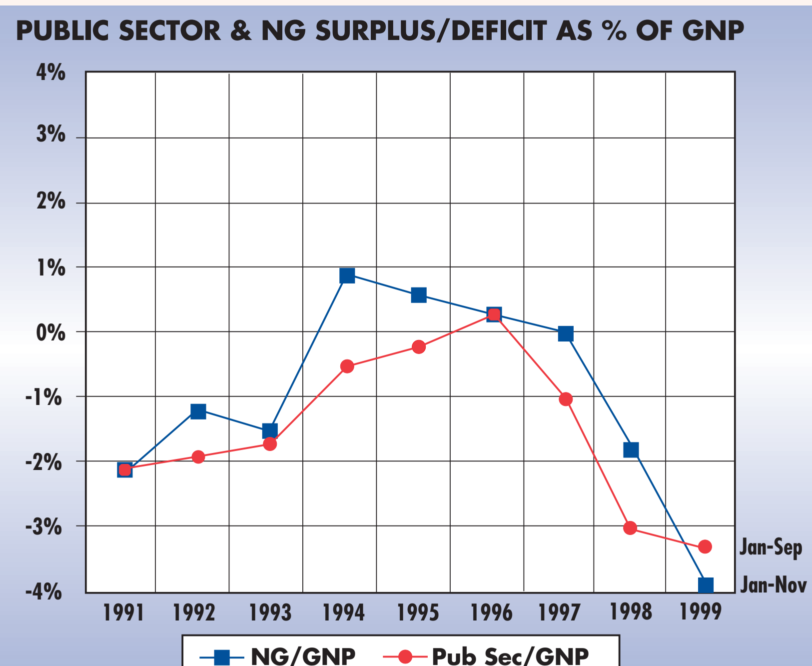
Sustaining fiscal viability remains the administration's most glaring problem and pressing challenge in its bid to break completely from the boom-and-bust pattern of the past. From nearly P50 billion (1.8% of GNP) in 1998, the Estrada administration's 1999 budget called for a P68.4 billion (2.2% of GNP) national government budget deficit in 1999 to help stimulate economic expansion. It set the consolidated public sector deficit (CPSD) — which includes the Bangko Sentral, government-controlled corporations, and government-administered social security agencies — at P97.1 billion (3.1% of GNP), up from 1998's P83.2 billion level.

The government officially revised those ceilings upward to P85.3 billion (2.8% of GNP) for the national government and P107.7 billion (3.5% of GNP) for the consolidated public sector after the September 1999 World Bank-IMF meetings due to persistent shortfalls in tax collection. By end-November, the national government's budget gap had ballooned to an estimated P110 billion. Government budget and finance officials said they would work to narrow the full-year budget gap by reviewing disbursements and collecting advances made to government firms. The government had reportedly received the IMF's approval for a full-year deficit of up to P101 billion (3% of GNP). Preliminary figures through September 1999 showed the CPSD at less than P75 billion, within program despite the national government's widening fiscal gap. This mainly reflected the stronger-than-forecasted performance of the government-administered social security agencies, as well as deferred capital outlays by government-controlled firms.

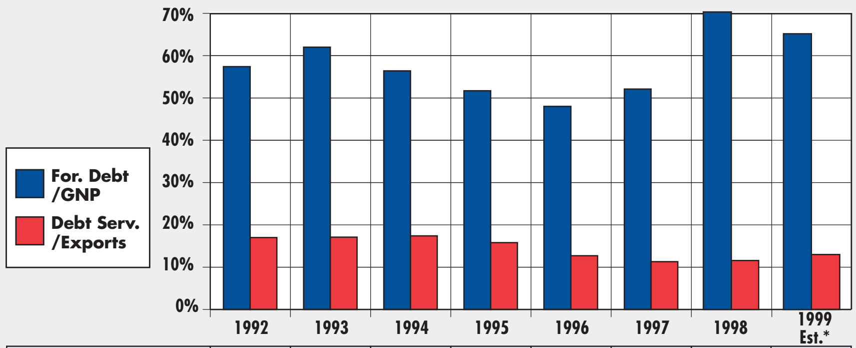
The government's medium-term fiscal policy envisions gradually declining deficits, beginning in 2000, achieving a balanced consolidated public sector budget in 2003. The Estrada Administration's 2000 budget proposed P631 billion in expenditures (P651 billion in budget authority), a 9.6% increase over 1999 disbursements. The Administration originally forecast 2000 revenues at P598 billion but later revised the forecast downward to P569 billion. The Senate, in particular, expressed skepticism about the revenue forecasts and demanded expenditure cuts. The Senate's original plan was to cut P52 billion from the proposed budget authority, more than half to come from transfers to local government. Objections from the Administration and local officials resulted in a heated debate. Since Congress failed to approve a 2000 budget before recessing for Christmas, Philippine law provides for the automatic application of the 1998 budget, equivalent to a continuing resolution in the U.S. Congress will have to tackle the budget in a special session on January 10-14. Congress and the Administration agree that the national government deficit should be held to P62.5 billion (1.8% of GNP) and the CPSD to P83.1 billion (2.4% of GNP).

Weak tax collections have been a long-standing problem, merely magnified by the Asian crisis. The government perennially has had to make unpalatable choices: tightening the rein on spending (at the expense of higher economic growth) or allowing the deficit to widen (at the expense of lower domestic interest rates). One study estimated that about half of value added and personal income taxes, and about 40% of corporate income taxes, escape collection. Inefficient tax collection has made it increasingly difficult for the government to justify higher taxes and new tax measures to narrow its deficit. Short-term measures such as the ERAP program (exempting taxpayers from audits as long as their tax payments in 1999 exceed 1998 payments by 20%) and a proposed tax amnesty — while expedient — do not send the appropriate signal that the government is serious about improving collection efforts. Major tax cases have languished in the courts.

Efforts to contain expenditures are hampered by the large share (over 70%) of "non-discretionary" expenditures such as payroll costs, interest payments and mandated transfers to local government units. Personnel-related costs alone constitute about a third of national gov-



FOREIGN DEBT RATIOS



	1992	1993	1994	1995	1996	1997	1998	1999 Est.*
FOREIGN DEBT/GNP (%)	57.4	62	56.4	51.7	48.1	53.0	70.1	65.0
DEBT SERVICE/ EXPORTS (%)	17	17.1	17.4	15.8	12.7	11.6	11.7	13.7

*Estimated from partial 1999 data.

ernment expenditures. Combined with weak revenues, this means that the government simply does not have the resources to seriously address the nation's many needs in health care, education and infrastructure. The proposed 2000 budget includes provisions for government "re-engineering." Serious reform to the government bureaucracy will require strong political will, especially under the Estrada administration's much-emphasized pro-poor agenda.

Government-controlled companies also impose a heavy load on public sector finances, making it imperative for the government to forge ahead with the privatization of financially burdened companies. Water supply and distribution in Metro Manila has already been privatized; similar efforts are being made in other cities. A power sector reform bill, pending before Congress, would restructure the electricity industry and privatize the government-owned National Power Corporation. The government was able to sell its stake in a copper smelter (PASAR) to private investors (including a Swiss firm). The immediate legal challenge to the sale, however, is illustrative of the problems the government faces in privatizing government-owned businesses.

Foreign Debt and Debt Service

The government relied heavily on foreign financing to fund the 1999 budget as part of its overall strategy to keep pressure off domestic interest rates. The national government had raised about $3.3 billion worth of bonds from international capital markets as of mid-December 1999, including Asia's first Euro-denominated sovereign bonds ($383 million). The Bangko Sentral also raised $700 million from the international capital markets, both to widen its international reserve cushion and to retire some of its short-term obligations. As of late 1999, it appeared very likely that the government's financing mix for the year 2000 would also rely heavily on foreign borrowings.

The Philippines technically graduated from over three decades of International Monetary Fund (IMF) supervision in March 1998, but promptly entered into a two-year "precautionary" arrangement due to the regional currency crisis. The Estrada administration converted this program to a regular $1.4 billion standby agreement in August 1998. As of mid-December, the government had drawn $755 million from the IMF standby facility. The government has indicated it will extend the arrangement through June 2000 and negotiate a follow-on standby arrangement.

The Philippines also continues to receive financial assistance from other bilateral and multilateral creditors, such as the Asian Development Bank, the World Bank, and Japan's Overseas Economic Cooperation Fund. As of mid-December, it had used $1.2 billion of the $1.9 billion pledged so far under the Miyazawa fund framework. The government also expects to tap the equivalent of over $350 million for projects approved thus far under Japan's Obuchi fund. The Asian Development Bank disbursed the first tranches of the Manila Air Quality loan (a total of $300 million plus a matching amount from Japan), and the Power Sector Restructuring loan (also totaling $300 million with a matching amount from Japan). The World Bank approved four loans totaling nearly $575 million for the Philippines in 1999, including a Banking Sector Reform Loan of $300 million. However, the Philippines has a poor record implementing development assistance projects, an issue raised repeatedly by its foreign donors. The Department of Budget and Management has created a "one-stop shop" for donor-funded projects in an effort to accelerate implementation.

The Philippines' recorded foreign debt was $48.1 billion as of end-June 1999, up $300 million from the end of 1998 but down from $48.6 billion as of March 1999. Bangko Sentral officials attributed the quarter-to-quarter decline mainly to foreign exchange revaluation adjustments and reduced banking sector liabilities. External obligations of the private non-bank sector — estimated at $12.5 billion (26% of outstanding external liabilities) — comprise a much smaller share of the foreign debt stock than in the Philippines' more distressed neighbors. Concessional loans from bilateral and multilateral creditors account for about half of the outstanding foreign debt level. The bias for medium- to long-term maturities — over 86% of obligations as of mid-1999 — has helped the Philippines avoid the serious difficulties experienced by neighboring economies.

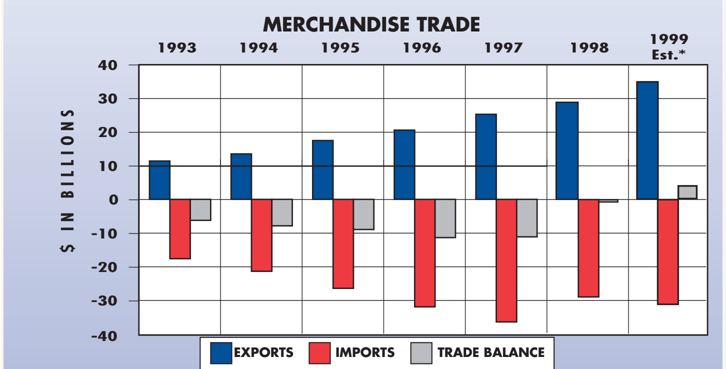
Although the foreign debt stock has been increasing, foreign debt servicing — which peaked at close to 40% of merchandise and service export receipts during the early 1980s — is no longer a severe problem. Debt service payments equaled 13.7% of goods and services exports during the first nine months of 1999. The government also continued to explore ways of improving maturities and terms on existing debts. It successfully launched a Brady bond exchange program last October, exchanging $850 million in Brady bonds for new 25-year, uncollateralized global bonds.

The debt service crisis of the 1980's and the Asian financial crisis painfully demonstrated that continued heavy reliance on external borrowing is not a viable long-term strategy. The Philippines' narrow export base also makes the country especially vulnerable to unexpected reversals in export markets. Furthermore, recovering regional economies and the demands of accelerating globalization may mean stiffer competition for foreign capital in the years ahead.

Merchandise Trade and Balance of Payments

Merchandise exports continued to grow at double-digit rates over 1998 levels during the second half of 1999. Third quarter exports increased by 22.8% year-on-year, accelerating from the first semester's 13.6% expansion. Export growth has been increasingly concentrated in electronic equipment and computer peripherals — which grew 29.7% during the third quarter of 1999. The electronics industry was boosted by larger September exports to Taiwan, following earthquake-related disruptions to the Taiwanese semiconductor industry. The sector now generates nearly two-thirds of the Philippines' export receipts. Total merchandise exports for the first nine-months of 1999 grew 17% over 1998, the rate at which exports expanded for the 1998 full-year. The 23.7% expansion in electronics and peripherals equalled almost 80% of the overall increase in export earnings.

Imports began to pick-up in mid-1999, led by imports of raw materials and intermediate goods. This reflects the heavy dependence of the electronics sector on imported components and, more generally, replenishment of drawn-down inventory levels. Total imports from June to September 1999 were up 10.1% year-on-year. That performance managed to offset the 4.2% decline during the first five months of the year, pushing nine-month imports up a modest 1.9% increase over the comparable 1998 level. Strong export growth and

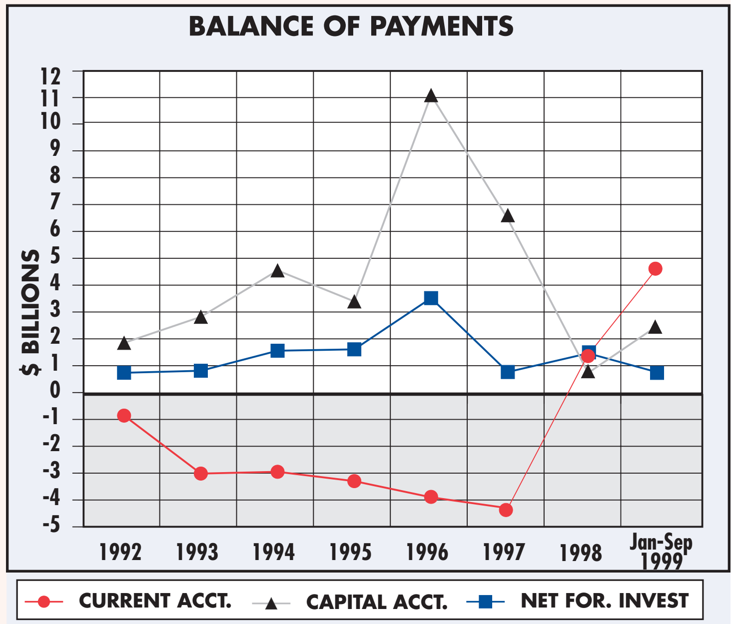


	1993	1994	1995	1996	1997	1998	1999 Est.*
EXPORTS	11.375	13.483	17.447	20.543	25.228	29.496	35.100
IMPORTS	-17.597	-21.333	-26.391	-31.885	-36.355	-29.524	-31.148
TRADE SURP/DEFICIT	-6.222	-7.850	-8.944	-11.342	-11.127	-0.028	3.952

*Estimated from partial 1999 data.

weak import demand narrowed the merchandise trade deficit to $28 million in 1998. As of September 1999, the Philippines had recorded a $2.4 billion trade surplus — the Philippines' first in 25 years.

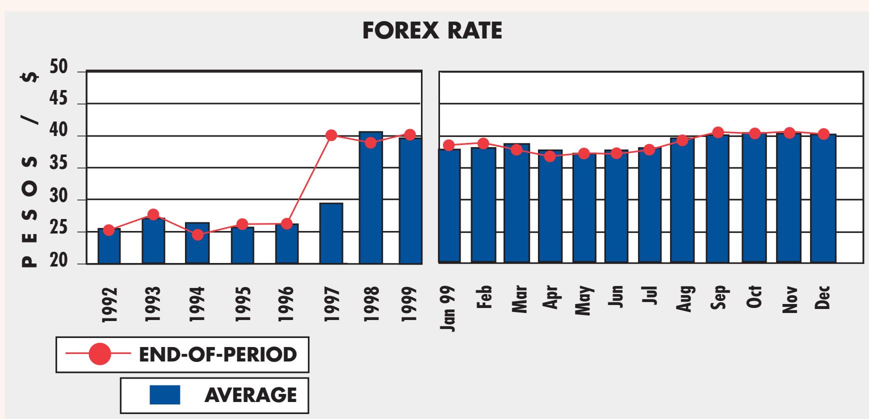
Preliminary estimates — computed from the change in BSP net international reserves — placed the country's overall BOP position at a surplus of $3.8 billion as of end-1999, almost triple 1998's comparable level. The merchandise trade surplus accounted for most of the overall surplus. The current account, which ended 1998 with a $1.3 billion surplus — the country's first in 12 years — stood at a $4.6 billion surplus as of September 1999.



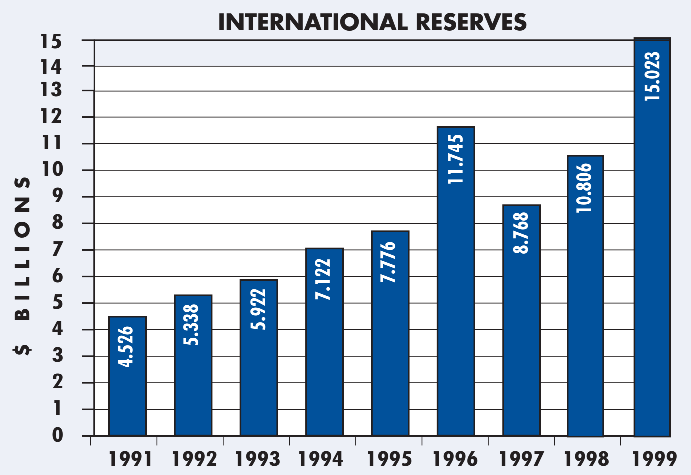
Foreign Exchange Rate and International Reserves

Like the equities market, the foreign exchange market remains prone to quick reversals in sentiment, fluctuating on regional and domestic news and rumors. After strengthening to as much as P37.50/$ over the course of 1999's first semester, the peso dropped over the summer months but managed to hold above the P40/$ mark from July to mid-September despite another emerging round of regional jitters and higher U.S. interest rates. However, the peso eventually trailed the baht and rupiah further down during the last quarter of 1999, flirting occasionally with the P41/$ level. A growing government deficit and political jitters over the Estrada administration's performance also weighed down the peso. Government officials comment that the country's wide current account surplus and healthy international reserve cushion do not justify the peso falling below the P40/$ mark. The foreign exchange rate ended 1999 at P40.25/$, weaker than the P39.09/$ rate at which it closed in 1998.

The BSP has been building up its international reserve cushion after reserves dipped to an end-1997 level of P8.8 billion (a level barely adequate for 1.9 months worth of goods and services imports). BSP international reserves — which the Bangko Sentral built-up to $10.8 billion by the end of 1998 (3 months worth of imports) — had risen further to a record month-end high of about $15 billion as of end-1999 (more than 4 months worth of imports). That international



*End-of-period data refers to average foreign exchange rate on last trading day of indicated period.



reserve cushion is also about double the estimated level of the Philippines' short-term foreign debt.

The BSP's measurement of adequacy of reserves in terms of months of import cover probably understates the strength of the Philippines' position. The changing nature of Philippine trade and the growth of electronics exports has increased imports of components for processing and re-export. These imports are "self-financing" in that they enter only in response to export orders that will pay for them. Considered "secondary reserves," the Bangko Sentral also estimated that banks' foreign currency deposit units (FCDUs) had about $14.6 billion in deposits as of August 1999, 86% of which represented deposits of Philippine residents.

Y2K Rollover

Confounding some alarmist predictions, the Y2K rollover passed with very few disruptions in the Philippines. The financial sector proved the value of its early remediation efforts and the air transport sector's later catch-up efforts paid off. The Philippines was aided by the relatively low level of computerization in many industries and by the country's long experience with service disruptions caused by everything from floods to jellyfish.

Challenges and Prospects

The economy's performance in 1999 has been good, leading to our expectation of GDP growth of up to 3.1% for the full year. As noted earlier, however, most of that growth is in agriculture, and thus is subject to vagaries of the weather. Broad, sustained and stable growth will depend on invigorating the industrial and service sectors to provide jobs and incomes. Market-based reforms to address perennial structural problems in the economy, and a continued opening of the economy to foreign trade and investment, are needed to move forward.

In the short to medium term, the government needs to move forcefully to address fiscal imbalances. The Philippines has historically suffered from weak tax collections; tax revenues here as a percentage of GDP are lower than in most other ASEAN countries. After transfers to local governments and government-owned corporations, nearly half of the government's spending goes to personnel costs, with another 20% to debt service. Poor fiscal performance is already impacting interest rates and international perceptions of the attractiveness of the Philippines as a place to invest. A more balanced fiscal regime would give the government more funds to complete badly needed infrastructure projects.

As we prepare for the next round of WTO talks, the Philippines now must move to implement fully the letter and the spirit of ASEAN, APEC and WTO commitments to cut tariffs and improve trade regimes. To continue to attract investment, the Philippines also needs to seriously deal with problems such as poor infrastructure, high costs of doing business (especially power and transport costs), and an inefficient and often corrupt bureaucracy and legal system.

The government also needs to shore up traditional investment draws such as its well-educated, English-speaking workforce. A rapidly expanding population and dwindling resources have already hampered education efforts throughout the country. A wave of investment in high-skill jobs could drain today's seemingly inexhaustible supply of well-trained workers with adequate language skills.

Agriculture suffers from low productivity (employing nearly 40% of the work force but only contributing about 20% of GDP). Poor rural infrastructure is a key part of the problem. Further, farmers (and consumers) are hurt by policies that are intended to protect them by restricting imports of agricultural commodities, but which result in the highest food costs in Southeast Asia. For example, sugar prices in the Philippines are nearly twice world levels, yet the industry is unprofitable and its farmers are among the poorest of the poor.

A highly skewed income distribution has both economic and social costs for the Philippines. The most recent statistics available (from 1997) show that the top 30% of families receive nearly two-thirds of the country's income, while the bottom 30% receive less than eight percent. Broader based economic growth would help to ensure jobs and incomes are spread more equitably.

PROJECTIONS FOR 1999: SELECTED INDICATORS

	1998 Actual	1999 Estimates[a]	2000 Forecast
GDP Growth (Year-on-year, %)	(0.5)	2.7-3.1	3.5-4.0
GNP Growth (Year-on-year, %)	0.1	3.2-3.6	4.0-4.5
Average Year-on-Year Inflation			
(1994=100, in %)	9.7	6.6 (actual)	7.0-7.5
Average 91-day T-bill rate (%)	15.3	10.58 (actual)	9.5-10.0
Average Forex Rate (Pesos/US$)	40.89	39.09 (actual)	40.50-41.50
Exports ($ Billions)	29.50	35.1	40.0
Growth (Year-on-year, %)	16.9	19.0	14.0
Imports ($ Billions)	29.52	31.1	35.8
Growth (Year-on-year, %)	(18.8)	5.5	15.0
Trade Balance ($ Billions)	(0.03)	4.0	4.2

[a]Embassy estimates based on partial 1999 data available as of December 1999.

Sources (1998 and 1999 data): National Economic and Development Authority, Bangko Sentral ng Pilipinas

PHILIPPINES: KEY ECONOMIC INDICATORS

(In Million USD, unless otherwise noted)

	1997	1998	1999 p	
Domestic Economy				
Population (millions)	71.8	73.5	75.2	
Population growth (%)	2.32	2.32	2.32	
GDP (current) ***a/***	82,241	65,111	73,845	annualized
GNP (current) ***a/***	85,744	68,215	77,744	Jan-Sep
Per Capita GDP, current dollars ***a/***	1,145	886	982	figures
Real GDP (% change, yr.-on-yr.)	5.2	(0.5)	2.6	Jan-Sep
Real GNP (% change, yr.-on-yr.)	5.3	0.1	3.0	Jan-Sep
Consumer Price Index (ave. % change, yr.-on-yr.) 1994=100	5.9	9.7	6.6	
Production, Employment, Fiscal Accounts				
Labor force (millions)	30.4	31.1	32.1	
Unemployment rate (%) ***b/***	8.7	10.1	9.6	
Industrial prod. (1985=100), % change yr.-on-yr.	6.1	(1.9)	(0.8)	Jan-Sep
Nat'l gov't budget surplus (deficit) ***a/***	53	(1,222)	(2,828)	Jan-Nov
as % of GNP	0.1	(1.8)	(3.9)	Jan-Nov
Consolidated public sector surplus (deficit) ***a/***	(816)	(2,034)	(1,912)	Jan-Sep
as % of GNP	(1.0)	(3.0)	(3.3)	Jan-Sep
Interest Rates (%)				
Average T-bill rate ***h/***	13.30	16.30	10.58	
Average bank loan rate ***c/***	16.22	18.39	11.93	Jan-Nov
Balance of Payments				
Exports (FOB)	25,228	29,496	29,016	Jan-Oct
Growth (%, yr.-on-yr.)	22.8	16.9	19.0	Jan-Oct
Imports (FOB)	36,355	29,524	25,721	Jan-Oct
Growth (%, yr.-on-yr.)	14.0	(18.8)	2.0	Jan-Oct
Trade Balance	(11,127)	(28)	3,295	Jan-Oct
Current Account balance	(4,303)	1,294	4,646	Jan-Sep
as % of GNP	(5.1)	1.9	8.0	Jan-Sep
BOP surplus/(deficit)	(3,383)	1,346	3,834	
Net foreign investment flows ***d/***	762	1,672	958	Jan-Sep
Foreign Debt, as of end of period ***e/***	45,433	47,817	48,128	June
Debt service paid	5,597	5,061	4,237	Jan-Sep
Debt service (% of exports of goods and services)	11.6	11.7	13.7	Jan-Sep
BSP International Reserves	8.768	10,806	15,023	
Exchange Rate (pesos/$)				
Average exchange rate	29.47	40.89	39.09	
Closing exchange rate ***f/***	40.12	39.14	40.30	
Foreign Direct Investment (BSP registrations) ***g/***				
Total (cumulative, since 1973)	8,420	9,305	10,737	Sep
U.S. (cumulative, since 1973)	2,479	2,722	2,806	Sep
U.S. share (%)	29.4	29.2	26.1	Sep
U.S.-Philippine Trade (U.S. data)				
Philippine exports to U.S., FOB	10,436	11,949	10,270	Jan-Oct
Growth (%, yr.-on-yr.)	27.9	14.5	1.7	Jan-Oct
Philippine imports from U.S., FOB	7,427	6,736	5,995	Jan-Oct
Growth (%, yr.-on-yr.)	21.3	(9.3)	(6.3)	Jan-Oct
Philippine trade balance with U.S.	3,009	5,213	4,275	Jan-Oct
U.S. share of Philippine imports (%)	20.4	22.8	23.1	Jan-Oct

a/ originally peso values, converted to USD; ***b/*** average of quarterly surveys (Jan/Apr/Jul/Oct); ***c/*** computed as the ratio of banks' actual interest income to outstanding loans (rather than quoted rates for a given period); ***d/*** direct and portfolio; ***e/*** since 1994, excludes "net due to" accounts of foreign commercial banks; ***f/*** average on last trading day of indicated period; ***g/*** principally exercised to enable forex purchase from the banking system for capital repatriation and profit remittances; ***h/*** weighted average for all maturities; ***p/*** preliminary

Sources: National Economic and Development Authority; Department of Finance; Bangko Sentral ng Pilipinas